Tennessee Board of Regents
Middle Tennessee State University

For the Year Ended
June 30, 2002

Arthur A. Hayes, Jr., CPA, JD, CFE
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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

John G. Morgan
Comptroller

April 22, 2003

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable Charles W. Manning, Chancellor
Tennessee Board of Regents
1415 Murfreesboro Road, Suite 350
Nashville, Tennessee 37217
and
Dr. Sidney A. McPhee, President
Middle Tennessee State University
110 Cope Administration Building
Murfreesboro, Tennessee 37132

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Board of Regents, Middle Tennessee State University, for the year ended June 30, 2002. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance resulted in no audit findings.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/mb
02/109

State of Tennessee

Audit Highlights

Comptroller of the Treasury — Division of State Audit

Financial and Compliance Audit
Middle Tennessee State University
For the Year Ended June 30, 2002

AUDIT OBJECTIVES

The objectives of the audit were to consider the university's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, contracts, and grants; to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

AUDIT FINDINGS

The audit report contains no findings.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report, which contains all findings, recommendations, and management comments, please contact

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Audit Report
Tennessee Board of Regents
Middle Tennessee State University
For the Year Ended June 30, 2002

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Tennessee Board of Regents
Middle Tennessee State University
For the Year Ended June 30, 2002

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Tennessee Board of Regents, Middle Tennessee State University. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated,* which authorizes the Department of Audit to "perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller."

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

Middle Tennessee State University was first established in 1911 as Middle Tennessee State Normal School in Murfreesboro, Tennessee. In 1925, when the General Assembly provided for three teachers' colleges—one in each of the grand divisions—Middle Tennessee State Normal School became Middle Tennessee State Teachers' College and gained the power to grant the Bachelor of Science degree. The college's name was changed to Middle Tennessee State College by an act of the legislature in 1943 and to Middle Tennessee State University by a special legislative act in 1956. The university is composed of the Graduate School, the Office of Continuing Studies and Public Service, and five undergraduate colleges: Basic and Applied Sciences, Business, Education, Liberal Arts, and Mass Communications.

ORGANIZATION

The governance of Middle Tennessee State University is vested in the Tennessee Board of Regents. The Governor, the Commissioner of Education, the Commissioner of Agriculture, and the Director of the Tennessee Higher Education Commission serve *ex officio* on this board. The chief administrative officer of the university is the president, who is assisted and advised by members of the faculty and administrative staff.

AUDIT SCOPE

The audit was limited to the period July 1, 2001, through June 30, 2002, and was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Financial statements are presented for the year ended June 30, 2002. Middle Tennessee State University is an institution of the Tennessee Board of Regents, which is an integral part of state government. As such, the Tennessee Board of Regents has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report.*

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the university's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;
2. to determine compliance with certain provisions of laws, regulations, contracts, and grants;
3. to determine the fairness of the presentation of the financial statements; and
4. to recommend appropriate actions to correct any deficiencies.

Although this audit was not intended to serve as an organization-wide audit as described in the Single Audit Act, as amended by the Single Audit Act Amendments of 1996, and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, it included tests of compliance with applicable federal laws and regulations and consideration of internal control used in administering federal financial assistance programs. This audit is a segment of the organization-wide audit of the State of Tennessee, which is conducted in accordance with the Single Audit Act.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the university's financial statements for the year ended June 30, 2002, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the university's financial statements.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
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Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

December 2, 2002

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the financial statements of Middle Tennessee State University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, as of and for the year ended June 30, 2002, and have issued our report thereon dated December 2, 2002. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. As discussed in Note 11, the university implemented GASB Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and GASB Statement 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*. The university also implemented GASB Statement 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus*, and GASB Statement 38, *Certain Financial Statement Note Disclosures*.

Compliance

As part of obtaining reasonable assurance about whether the university's financial statements are free of material misstatement, we performed tests of the university's compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

We did, however, note certain less significant instances of noncompliance, which we have reported to the university's management in a separate letter.

<u>Internal Control Over Financial Reporting</u>

In planning and performing our audit, we considered the university's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

However, we noted certain matters involving the internal control over financial reporting, which we have reported to the university's management in a separate letter.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

Arthur A. Hayes, Jr., CPA,
Director

AAH/mb

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
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Independent Auditor's Report

December 2, 2002

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying statement of net assets of Middle Tennessee State University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, as of June 30, 2002, and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the university's management. Our responsibility is to express an opinion on these financial statements, based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Tennessee Board of Regents, Middle Tennessee State University, as of June 30, 2002, and the revenues, expenses, and changes in net assets and the cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 11, the university implemented GASB Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and GASB Statement 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*. The university also implemented GASB Statement 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus*, and GASB Statement 38, *Certain Financial Statement Note Disclosures*.

The management's discussion and analysis on pages 8 through 16 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 2, 2002, on our consideration of the university's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA,
Director

AAH/mb

MIDDLE TENNESSEE STATE UNIVERSITY
Management's Discussion and Analysis

This section of Middle Tennessee State University's annual financial report presents a discussion and analysis of the financial performance of the university during the fiscal year ended June 30, 2002. This discussion has been prepared by management along with the financial statements and related note disclosures and should be read in conjunction with the financial statements and notes. The financial statements, notes, and this discussion are the responsibility of management.

Since this is a transition year for the new financial reporting format required by the Governmental Accounting Standards Board's Statements No. 34, "Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments" and No. 35, "Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities," only one year of information is presented in the financial statements and this discussion. Comparative information will be presented in future years.

Using This Annual Report

This report consists of three basic financial statements. The Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows provide information on Middle Tennessee State University as a whole and present a long-term view of the university's finances.

The Statement of Net Assets

The Statement of Net Assets presents the financial position of the university at the end of the fiscal year and includes all assets and liabilities of the university. The difference between total assets and total liabilities—net assets—is an indicator of the current financial condition of the university. Assets and liabilities are generally measured using current values. One notable exception is capital assets, which are stated at historical cost less an allowance for depreciation.

Net assets are divided into three major categories. The first category, invested in capital assets, net of related debt, provides the university's equity in property, plant, and equipment owned by the university. The next asset category is restricted net assets, which is divided into two categories, nonexpendable and expendable. The corpus of nonexpendable restricted resources is only available for investment purposes. Expendable restricted net assets are available for expenditure by the university but must be spent for purposes as determined by donors and/or external entities that have placed time or purpose restrictions on the use of the assets. The final category is unrestricted net assets. Unrestricted net assets are available to the institution for any lawful purpose of the institution.

Statement of Net Assets
(in thousands of dollars)

	2002
Assets	
Current assets	$ 65,570
Capital assets, net	182,612
Other assets	27,340
Total assets	**275,522**
Liabilities:	
Current liabilities	69,340
Noncurrent liabilities	80,875
Total liabilities	**150,215**
Net assets:	
Invested in capital assets, net of related debt	87,837
Restricted – nonexpendable	626
Restricted – expendable	6,871
Unrestricted	29,973
Total net assets	**$125,307**

Some highlights of material assets and liabilities included on the Statement of Net Assets are as follows:

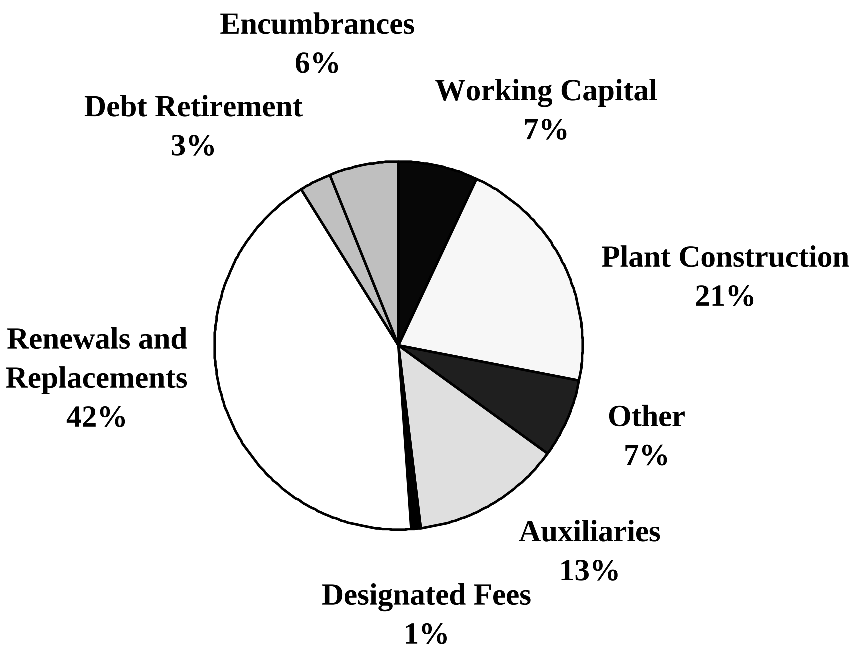
- The capital assets category for the university includes the following specific items: land, improvements and infrastructure, buildings, equipment, library holdings, and projects in progress. These are shown net of accumulated depreciation. Current year additions for capital assets totaled $11,514,296 for the university and $11,711,993 for the foundation.

- Current liabilities consisted primarily of deposits held in custody for others in the amount of $46,816,269. This category represents funds being held for use by the MTSU Foundation and other outside agencies. The university does not make any decisions on how these funds are invested or spent. These decisions remain with the agencies' representatives or Boards of Directors.

- Noncurrent liabilities included $75,474,018 in long-term liabilities. Of this amount, $73,606,884 is bonds payable and $1,867,134 represents outstanding commercial paper. The Tennessee State School Bond Authority administers all financing activities of the university. Additions to debt instruments for the year totaled $8,492,506. Another portion of noncurrent liabilities was a liability for compensated absences in the amount of $2,119,003. This amount represents annual and compensatory leave accrued by university personnel but not expected to be taken over the next fiscal year. The remaining portion of noncurrent liabilities was for amounts due to grantors of $3,282,035, which included U.S. government grants refundable under the Perkins Loan program and a litigation settlement.

Many of the university's unrestricted net assets have been designated or reserved for specific purposes such as: working capital, encumbrances, designated fees, auxiliaries, plant construction, renewal and replacement of equipment, and debt retirement. The following graph shows the allocations:

Allocation of Unrestricted Net Assets



The Statement of Revenues, Expenses, and Changes in Net Assets

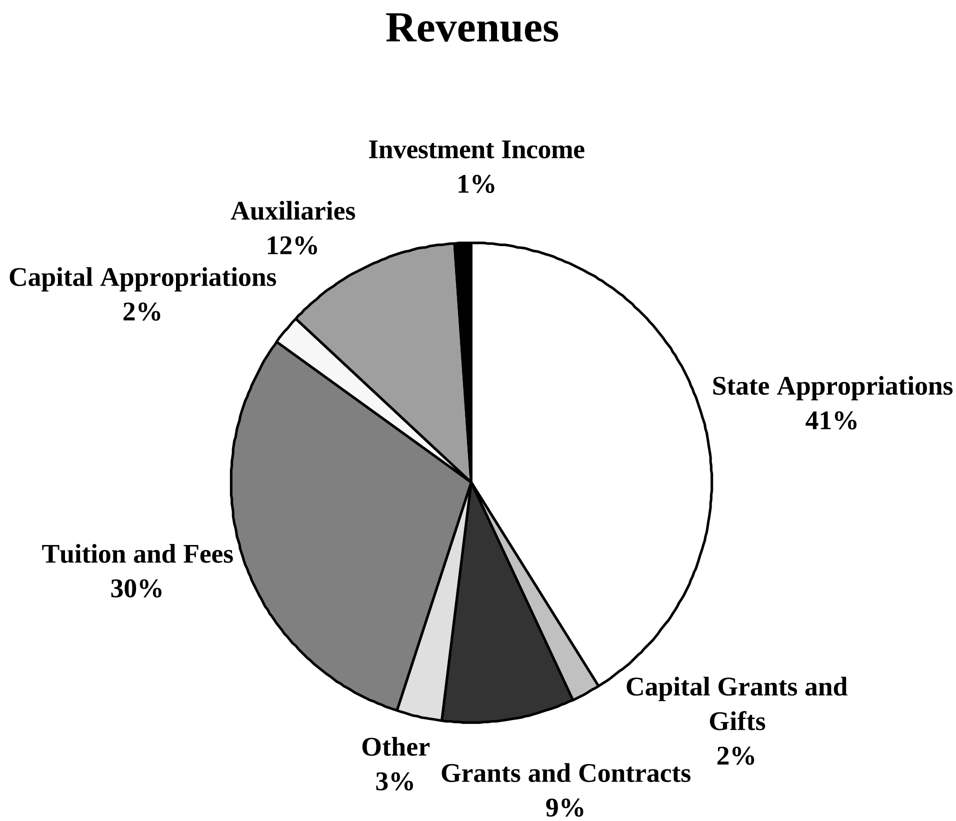
The Statement of Revenues, Expenses, and Changes in Net Assets presents the operating results of the university, as well as the nonoperating revenues and expenses. Annual state appropriations, while budgeted for operations, are considered nonoperating revenues according to generally accepted accounting principles.

Statement of Revenues, Expenses, and Changes in Net Assets
(in thousands of dollars)

	2002
Operating revenues:	
Net tuition and fees	$ 57,385
Grants and contracts	18,632
Auxiliaries	23,628
Other	4,975
Total operating revenues	**104,620**
Operating expenses	189,583
Operating loss	**(84,963)**
Nonoperating revenues and expenses:	
State appropriations	79,049
Gifts	901
Investment income	1,623
Other revenues and expenses	(3,112)
Total nonoperating revenues and expenses	**78,461**
Loss before other revenues, expenses, gains, or losses	**(6,502)**
Other revenues, expenses, gains, or losses:	
Capital appropriations	3,642
Capital grants and gifts	3,469
Total other revenues, expenses, gains, or losses	**7,111**
Increase in net assets	**609**
Net assets at beginning of year, as originally reported	256,373
Cumulative effect of changes in accounting principle	(131,675)
Net assets at beginning of year, as restated	**124,698**
Net assets at end of year	**$125,307**

Revenues

The following is a graphic illustration of revenues by source (both operating and nonoperating), which are used to fund the university's operating activities for the year.



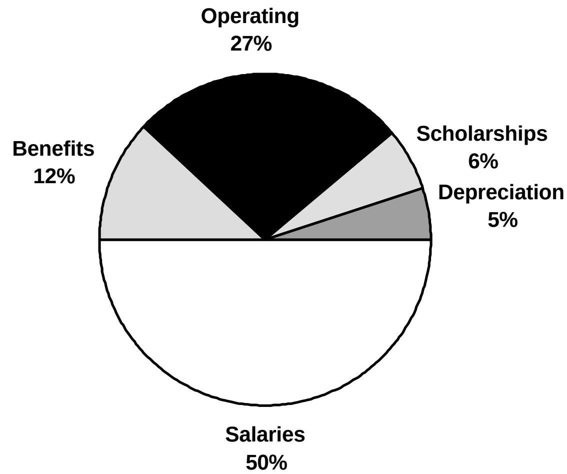
- Revenues are mainly comprised of state appropriations (41%) and tuition and fees (30%). State appropriations are considered nonoperating revenues because they are provided by the legislature to the university without the legislature receiving any goods and services for those revenues, whereas tuition and fees are considered operating revenues due to the direct benefit received by students of the university.

- Auxiliary enterprise revenues make up 12% of total revenues of the university. University auxiliary units consist of a university bookstore, food service and vending, housing operations, parking services, health services, student recreation center, postal services, and telecommunications.

Expenses

Operating expenses can be displayed in two formats, natural classification and program classification. Both formats are displayed below (in thousands of dollars).

Expenses by Natural Classification

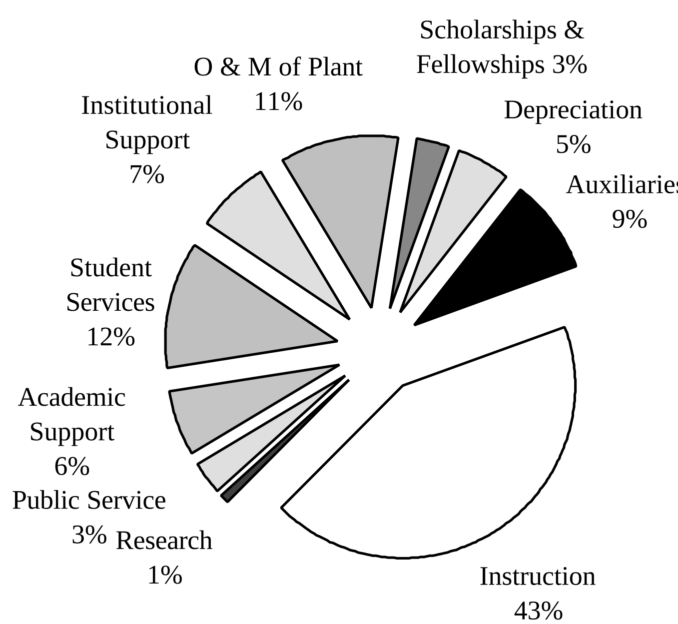


Natural Classification
(in thousands)

	2002
Salaries	$ 95,356
Benefits	23,191
Operating	50,070
Scholarships	10,871
Depreciation	10,095
Total	**$189,583**

- Salaries comprise 50% of total expenses for the university. These include faculty, administrative, clerical and support, and student wages.
- Operating expenses, which represent 27% of the total expenses, include such items as travel, operating supplies, and utilities.

Expenses by Program Classification



Program Classification
(in thousands)

	2002
Instruction	$ 81,947
Research	2,695
Public service	6,150
Academic support	11,236
Student services	21,849
Institutional support	12,856
Operation and maintenance	19,962
Scholarships & fellowships	4,846
Auxiliaries	17,947
Depreciation	10,095
Total	**$189,583**

- The instruction program classification represents 43% of total university expenses for the year. This classification includes expenses incurred by all of the university's academic colleges.

- Operation and maintenance of plant expenses comprise 11% of total expenses. These expenses are incurred all across the university in the upkeep, operation, and renovations of all plant buildings and equipment.

The Statement of Cash Flows

The Statement of Cash Flows provides information about cash receipts and cash payments during the year. This statement also assists users in assessing the university's ability to generate net cash flows, its ability to meet its obligations as they come due, and its need for external financing.

Statement of Cash Flows
(in thousands of dollars)

	2002
Cash provided (used) by:	
Operating activities	$(70,056)
Noncapital financing activities	77,653
Capital and related financing activities	(5,967)
Investing activities	1,666
Net increase in cash	**3,296**
Cash, beginning of year	**55,605**
Cash, end of year	**$58,901**

- In the operating activities section of the statement of cash flows, tuition and fees represents the largest source of cash for the university in the amount of $58,937,540. The two largest uses of cash for the university are payments to employees totaling $92,453,016 and payments to suppliers and vendors for $49,689,906.

- In the noncapital financing activities section of the statement, state appropriations represent the largest source of cash in the amount of $78,250,300.

- In the capital and related financing activities section of the statement, proceeds from the issuance of capital debt amounted to $13,035,265. This represents bonds and commercial paper issued by the Tennessee State School Bond Authority on behalf of the university. Funds in this category were used in the amount of $11,508,396 for the purchase and construction of capital assets on the university's campus.

- The university's cash position for the year increased by $3,296,045.

Capital Assets and Debt Administration

Capital Assets

At June 30, 2002, Middle Tennessee State University had $165,701,662 invested in capital assets, net of accumulated depreciation of $105,985,606. Depreciation charges totaled $10,094,641 for the current fiscal year. At June 30, 2002, the Middle Tennessee State University Foundation had $16,909,912 invested in capital assets, net of accumulated depreciation of $166,559. Depreciation charges totaled $7,026 for the current fiscal year. Details of these assets are shown below.

Schedule of University Capital Assets, Net of Depreciation
(in thousands of dollars)

	2002
Land	$ 4,449
Land improvements & infrastructure	14,142
Buildings	128,186
Equipment	9,182
Library holdings	7,851
Projects in progress	1,891
Total	$165,701

Schedule of Foundation Capital Assets, Net of Depreciation
(in thousands of dollars)

	2002
Land	$ 3,615
Equipment	38
Projects in progress	13,257
Total	$16,910

The university was able to purchase two properties, including buildings on each property, during the fiscal year: Belle Aire and St. Marks properties. Both of these properties were purchased with the use of commercial paper and bonds issued by the Tennessee State School Bond Authority (TSSBA) in the amount of $3,000,000, along with $500,000 in local funds, for a total project budget for both properties of $3,500,000. A construction project to renovate several dorms on campus was substantially complete by the end of the fiscal year with the remaining work to be completed in the upcoming fiscal year. Bonds issued by TSSBA in the amount of $7,000,000, along with $1,500,000 in local funds, are funding this project. A chiller conversion project was completed during the year with $865,000 in bonds used for funding the project.

Several projects were being planned in the late part of the fiscal year which will be substantially completed in the upcoming fiscal year. A Development Facility will be constructed to house our fundraising activities in the amount of $1,275,000. Funding for this project will be a combination of bonds issued by TSSBA and local plant construction funds. Private gifts have been received or pledged for the construction of a new Honors College building on the campus, with a total budget of $4,150,000. The Smith Hall Complex renovation project is another housing renovation that is projected to start in the upcoming fiscal year, funded by bonds issued by TSSBA with a total project budget of $11,570,000. More detailed information about the university's and foundation's capital assets is presented in Note 6 to the financial statements.

Debt

At June 30, 2002, the university had $77,864,088 in debt outstanding. The table below summarizes the amounts by type of debt instrument (in thousands of dollars).

TSSBA Bonds	$ 75,997
TSSBA Commercial Paper	1,867
Total debt	$ 77,864

The Tennessee State School Bond Authority issued new bonds on behalf of the university for the following four projects during the year: construction of a new development facility, renovations for housing, the chillers conversion project, and the purchase of the St. Marks property. TSSBA earned an "AA" bond rating for the fiscal year. More detailed information about the university's long-term liabilities is presented in Note 7 to the financial statements.

Economic Factors That Will Affect the Future

The university is not aware of any currently known facts, decisions, or conditions that are expected to have a significant effect on financial position or results of operations in the future. State funding for the upcoming fiscal year is increasing by $4,843,200 for the university. Across the board fee increases have been approved by the Tennessee Board of Regents, which increased student fees by 7.5%.

MIDDLE TENNESSEE STATE UNIVERSITY
STATEMENT OF NET ASSETS
JUNE 30, 2002

ASSETS		
Current assets:		
Cash and cash equivalents (Notes 2 and 3)	$	35,038,192.63
Short-term investments (Note 4)		18,004,475.08
Accounts, notes, and grants receivable (net) (Note 5)		9,529,796.75
Inventories (at lower of cost or market)		2,702,891.96
Prepaid expenses and deferred charges		214,720.78
Accrued interest receivable		80,236.19
Total current assets		65,570,313.39
Noncurrent assets:		
Cash and cash equivalents (Notes 2 and 3)		17,921,932.03
Investments (Note 4)		657,880.41
Accounts, notes, and grants receivable (net) (Note 5)		2,777,376.26
LGIP deposit - capital projects (Note 2)		5,941,172.82
Deposit with trustee (Note 7)		41,642.80
Capital assets (net) (Note 6)		182,611,574.32
Total noncurrent assets		209,951,578.64
Total assets		275,521,892.03
LIABILITIES		
Current liabilities:		
Accounts payable		2,017,414.28
Accrued liabilities		11,104,457.94
Student deposits		892,632.81
Deferred revenue		3,651,554.27
Compensated absences (Note 7)		1,668,834.24
Accrued interest payable		698,974.42
Long-term liabilities, current portion (Note 7)		2,390,069.35
Deposits held in custody for others		46,816,269.02
Other liabilities		99,651.53
Total current liabilities		69,339,857.86
Noncurrent liabilities:		
Compensated absences (Note 7)		2,119,002.75
Long-term liabilities (Note 7)		75,474,018.42
Due to grantors (Note 7)		3,282,034.74
Total noncurrent liabilities		80,875,055.91
Total liabilities		150,214,913.77
NET ASSETS		
Invested in capital assets, net of related debt		87,837,574.10
Restricted for:		
Nonexpendable:		
Scholarships and fellowships		10,900.00
Other		614,899.93
Expendable:		
Scholarships and fellowships		59,177.92
Research		139,235.99
Instructional department uses		87,514.73
Loans		1,640,845.51
Capital projects		3,256,320.62
Debt service		908,158.61
Other		779,390.67
Unrestricted (Note 8)		29,972,960.18
Total net assets	$	125,306,978.26

The notes to the financial statements are an integral part of this statement.

Exhibit B

MIDDLE TENNESSEE STATE UNIVERSITY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2002

REVENUES		
Operating revenues:		
Student tuition and fees (net of scholarship allowances of $11,966,041.32)	$	57,385,162.99
Governmental grants and contracts		18,026,318.29
Nongovernmental grants and contracts		606,037.19
Sales and services of educational departments		4,572,127.19
Auxiliary enterprises:		
Residential life (all residential life revenues are used as security for revenue bonds; see Note 7)		10,635,144.14
Bookstore		8,187,911.61
Food service		475,246.47
Wellness facility (all wellness facility revenues are used as security for revenue bonds; see Note 7)		1,256,838.37
Other auxiliaries		3,072,368.11
Interest earned on loans to students		101,509.15
Other operating revenues		301,023.75
Total operating revenues		104,619,687.26
EXPENSES		
Operating expenses (Note 15):		
Salaries and wages		95,356,489.53
Benefits		23,191,166.09
Utilities, supplies, and other services		50,069,851.87
Scholarships and fellowships		10,871,191.29
Depreciation expense		10,094,640.50
Total operating expenses		189,583,339.28
Operating loss		(84,963,652.02)
NONOPERATING REVENUES (EXPENSES)		
State appropriations		79,049,100.00
Gifts		901,142.70
Investment income (net of investment expense of $527,095.16)		1,623,221.14
Interest on capital asset-related debt		(3,926,514.41)
Other nonoperating revenues (expenses)		814,275.35
Net nonoperating revenues		78,461,224.78
Loss before other revenues, expenses, gains, or losses		(6,502,427.24)
Capital appropriations		3,642,168.62
Capital grants and gifts		3,469,196.77
Total other revenues		7,111,365.39
Increase in net assets		608,938.15

MIDDLE TENNESSEE STATE UNIVERSITY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2002

NET ASSETS		
Net assets - beginning of year (Note 16)		256,372,816.82
Cumulative effects of changes in accounting principle (Note 11)		
Adoption of capitalization criteria for buildings and additions		(2,234,914.27)
Adoption of depreciation for capital assets		(127,466,383.88)
Deferred revenue recognition		799,665.81
Other		(2,773,144.37)
Net assets - beginning of year, as restated		124,698,040.11
Net assets - end of year	$	125,306,978.26

The notes to the financial statements are an integral part of this statement.

Exhibit C

MIDDLE TENNESSEE STATE UNIVERSITY
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2002

CASH FLOWS FROM OPERATING ACTIVITIES		
Tuition and fees	$	58,937,540.43
Grants and contracts		18,206,771.92
Sales and services of educational activities		4,557,156.04
Payments to suppliers and vendors		(49,689,905.98)
Payments to employees		(92,453,015.70)
Payments for benefits		(22,459,781.06)
Payments for scholarships and fellowships		(10,871,191.29)
Interest earned on loans to students		101,302.16
Auxiliary enterprise charges:		
Residence halls		10,675,289.34
Bookstore		7,795,352.44
Food services		504,418.88
Wellness facility		1,256,838.37
Other auxiliaries		3,081,994.42
Other receipts (payments)		301,023.75
Net cash used by operating activities		(70,056,206.28)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations		78,250,300.00
Gifts and grants received for other than capital or endowment purposes		868,287.86
Federal student loan receipts		136,707.54
Federal student loan disbursements		(154,773.86)
Changes in deposits held for others		(1,447,191.02)
Net cash provided by noncapital financing activities		77,653,330.52
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from capital debt		13,035,264.76
Capital - state appropriations		3,642,168.62
Capital grants and gifts received		3,463,296.77
Purchases of capital assets and construction		(11,508,395.79)
Principal paid on capital debt and lease		(9,760,455.47)
Interest paid on capital debt and lease		(3,927,751.66)
Deposit with trustee		(1,735,100.84)
Other capital and related financing receipts (payments)		823,817.22
Net cash used by capital and related financing activities		(5,967,156.39)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments		66,449.43
Income on investments		1,691,127.32
Purchases of investments		(91,500.00)
Net cash provided by investing activities		1,666,076.75

MIDDLE TENNESSEE STATE UNIVERSITY
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2002

Net increase in cash and cash equivalents		3,296,044.60
Cash and cash equivalents - beginning of year		55,605,252.88
Cash and cash equivalents - end of year	$	58,901,297.48

Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$	(84,963,652.02)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense		10,094,640.50
Change in assets and liabilities:		
Receivables, net		(735,107.07)
Inventories		(305,103.10)
Prepaid/deferred items		90,516.18
Other assets		(206.99)
Accounts payable		(718,575.69)
Accrued liabilities		3,321,586.28
Deferred revenue		1,917,804.29
Deposits		152,901.82
Compensated absences		338,105.56
Due to grantors		750,883.96
Net cash used by operating activities	$	(70,056,206.28)

The notes to the financial statements are an integral part of this statement.

Tennessee Board of Regents
Middle Tennessee State University
Notes to the Financial Statements
June 30, 2002

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The university is a part of the State University and Community College System of Tennessee (Tennessee Board of Regents). This system is a component unit of the State of Tennessee because the state appoints a majority of the system's governing body and provides financial support; the system is discretely presented in the *Tennessee Comprehensive Annual Financial Report*.

Basis of Presentation

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). In June 1999, the GASB issued Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. This was followed in November 1999 by GASB Statement 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*. The financial presentation required by those statements provides a comprehensive, entity-wide perspective of the university's assets, liabilities, net assets, revenues, expenses, changes in net assets, and cash flows, and replaces the fund-group perspective previously required.

Significant accounting changes made in order to comply with the new requirements include (1) adoption of depreciation on capital assets and (2) reporting summer school revenues and expenses between fiscal years rather than in one fiscal year.

Basis of Accounting

For financial statement purposes, the university is considered a special-purpose government engaged only in business-type activities. Accordingly, the financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met. All significant interfund transactions have been eliminated.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The university has the option of following private-sector guidance issued subsequent to November 30, 1989, subject to the above limitation. The university has elected not to follow private-sector guidance issued subsequent to November 30, 1989.

Amounts reported as operating revenues include (1) tuition and fees, net of waivers and discounts; (2) federal, state, local, and private grants and contracts; (3) sales and services of auxiliary enterprises; and (4) other sources of revenue. Operating expenses for the university include (1) salaries and wages; (2) employee benefits; (3) scholarships and fellowships; (4) depreciation; and (5) utilities, supplies, and other services.

All other activity is nonoperating in nature and includes (1) state appropriations for operations; (2) investment income; (3) bond issuance costs; (4) interest on capital asset-related debt; and (5) gifts.

When both restricted and unrestricted resources are available for use, generally it is the university's policy to use the restricted resources first.

LGIP Deposit – Capital Projects

Payments related to the university's capital projects are made by the State of Tennessee's Department of Finance and Administration. The university's estimated local share of the cost of each project is held in a separate Local Government Investment Pool (LGIP) account. As expenses are incurred, funds are withdrawn from the LGIP account by the Tennessee Board of Regents and transferred to the Department of Finance and Administration. The funds in the account are not available to the university for any other purpose until the project is completed and the Tennessee Board of Regents releases any remaining funds.

Inventories

Inventories are valued at the lower of cost or market. Textbooks included in the inventory are recorded on a first-in, first-out basis. All other items are maintained on an average cost or first-in, first-out basis.

Compensated Absences

The university's employees accrue annual leave at varying rates, depending on length of service or classification. Some employees also earn compensatory time. The amount of these liabilities and their related benefits are reported in the statement of net assets.

Capital Assets

Capital assets, which include property, plant, equipment, and library holdings, are reported in the statement of net assets at historical cost or at fair value at date of donation, less accumulated depreciation. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset's useful life are not capitalized.

A capitalization threshold of $100,000 is used for buildings, $50,000 for additions and improvements to land, buildings, or infrastructure, and $5,000 for equipment.

These assets, with the exception of land, are depreciated using the straight-line method over the estimated useful lives, which range from 5 to 40 years.

Middle Tennessee State University Foundation

The university is the sole beneficiary of the Middle Tennessee State University Foundation. A board independent of the university controls this private, nonprofit foundation. The university handles the financial records, investments, and other financial transactions, and the assets and liabilities of the foundation are included on the university's statement of net assets.

Net Assets

The university's net assets are classified as follows:

<u>Invested in capital assets, net of related debt</u> – This represents the university's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

<u>Nonexpendable restricted net assets</u> – Nonexpendable restricted net assets consist of endowment and similar type funds in which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained

inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may be expendable or added to principal.

<u>Expendable restricted net assets</u> – Expendable restricted net assets include resources which the university is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.

<u>Unrestricted net assets</u> – Unrestricted net assets represent resources derived from student tuition and fees, state appropriations, and sales and services of educational departments and auxiliary enterprises. These resources are used for transactions relating to the educational and general operations of the university, and may be used at the discretion of the university to meet current expenses for any purpose. The auxiliary enterprises are substantially self-supporting activities that provide services for students, faculty, and staff.

Scholarship Discounts and Allowances

Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship discounts and allowances in the statement of revenues, expenses, and changes in net assets. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the university and the amount that is paid by the student and/or third parties making payments on the student's behalf. Certain governmental grants, such as Pell grants, and other federal, state, or nongovernmental programs, are recorded as either operating or nonoperating revenues in the university's financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees and other student charges, the university has recorded a scholarship discount and allowance.

Comparative Data

Comparative financial statements are not presented as the university implemented GASB Statements 34, 35, 37, and 38, and comparative statements are not required. Certain amounts presented in prior years' data have been reclassified to be consistent with the current year's presentation.

NOTE 2. CASH AND CASH EQUIVALENTS

In addition to demand deposits and petty cash on hand, this classification includes instruments which are readily convertible to known amounts of cash and which have original maturities of three months or less. At June 30, 2002, cash and cash equivalents consisted of $4,503,094.94 in bank accounts, $117,093.00 of petty cash on hand, $45,896,560.71 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, and $2,443,376.01 in money market accounts.

For purposes of the statement of cash flows, the university considers the LGIP deposit - capital projects to be a part of cash and cash equivalents.

NOTE 3. DEPOSITS

The university's deposits are in financial institutions that participate in the bank collateral pool administered by the State Treasurer. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure.

At June 30, 2002, the carrying amount of the university's deposits was $6,946,470.95, and the bank balance including accrued interest was $8,900,879.59. The bank balance was insured.

The laws of the State of Tennessee require that collateral be pledged to secure all uninsured deposits. Tennessee Board of Regents policies require that the market value of collateral pledged equal 115%, 100%, or 90% of the uninsured deposits at financial institutions participating in the collateral pool. The pledge level is based on financial criteria set by the Collateral Pool Board with the financially strongest institutions being eligible for the lowest pledge level.

The university also has deposits in the Local Government Investment Pool (LGIP) administered by the State Treasurer. The LGIP is part of the Pooled Investment Fund. The fund's investment policy and custodial credit risk are presented in the *Tennessee*

Comprehensive Annual Financial Report. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

NOTE 4. INVESTMENTS

The university is authorized by statute to invest funds in accordance with Tennessee Board of Regents policies. Under the current policy, funds other than endowments may be invested only in obligations of the United States or its agencies backed by the full faith and credit of the United States; repurchase agreements for United States securities; certificates of deposit in banks and savings and loan associations; bankers' acceptances; commercial paper; money market mutual funds; and the State of Tennessee Local Government Investment Pool. The policy requires that investments of endowments in equity securities be limited to funds from private gifts or other sources external to the university and that endowment investments be prudently diversified. The Middle Tennessee State University Foundation is authorized to invest funds in accordance with its board of directors' policies.

All investments permitted to be reported at fair value under GASB Statement 31 are reported at fair value, including those with a maturity date of one year or less at the time of purchase.

The foundation's investments are categorized below to indicate the level of risk assumed by the foundation at year-end. Category 2 consists of uninsured and unregistered investments for which the securities are held by the counterparties' trust department or agent in the foundation's name. Category 3 consists of uninsured and unregistered investments for which the securities are held by the counterparty or by its trust department or agent but not in the foundation's name.

	Fair Value
Category 2:	
U.S. government securities	$ 296,852.43
Corporate bonds	1,275,199.10
Corporate stocks	8,919,352.04

Investments not susceptible to credit risk categorization:	
Mutual funds	8,170,951.92
Total investments on the statement of net assets	$18,662,355.49

Investments of endowment and similar funds are composed of the following:

	Carrying Value
Mutual funds	$657,880.41

Assets of endowments are pooled on a fair value basis, with each individual fund subscribing to or disposing of units on the basis of the fair value per unit at the beginning of the calendar quarter within which the transaction takes place. The 130,008.658 units at June 30, 2002, each having a fair value of $5.06, were owned by quasi-endowments.

The following tabulation summarizes changes in relationships between cost and fair values of the pooled assets:

	Pooled Assets		Net Gains	Fair Value
	Fair Value	Cost	(Losses)	Per Unit
End of year	$657,880.41	$719,666.06	$(61,785.65)	$5.06
Beginning of year	$653,194.02	$710,641.16	(57,447.14)	4.94
				$0.12
Unrealized net losses			(4,338.51)	
Realized net losses			(14,925.24)	
Total net losses			$(19,263.75)	

The average annual earnings per unit, exclusive of net gains, were $0.12 for the year.

Investments of endowment and similar funds owned by the foundation are composed of the following:

	Carrying Value
Mutual funds	$7,513,071.51

Assets of endowments are pooled on a fair value basis, with each individual fund subscribing to or disposing of units on the basis of the fair value per unit at the beginning of the calendar quarter within which the transaction takes place. The 706,935.085 units at June 30, 2002, each having a fair value of $10.63, were owned by endowments.

The following tabulation summarizes changes in relationships between cost and fair values of the pooled assets:

	Pooled Assets		Net Gains	Fair Value
	Fair Value	Cost	(Losses)	Per Unit
End of year	$7,513,071.51	$7,548,608.60	$(35,537.09)	$10.63
Beginning of year	$ 45,710.13	$ 48,608.60	(2,898.47)	11.34
				$(0.71)
Unrealized net losses			(32,638.62)	
Realized net gains			-	
Total net losses			$(32,638.62)	

There were no average annual earnings per unit, exclusive of net gains, for the year.

NOTE 5. RECEIVABLES

Receivables at June 30, 2002, included the following:

Student accounts receivable	$3,055,031.66
Grants receivable	3,506,642.43
Notes receivable	563,983.37
Pledges receivable	1,247,000.00
Other receivables	2,526,831.64
Subtotal	10,899,489.10
Less allowance for doubtful accounts	1,369,692.35
Total receivables	$9,529,796.75

Pledges receivable are promises of private donations that are reported as accounts receivable and revenue. At June 30, 2002, all were considered to be collectible.

Federal Perkins Loan Program funds at June 30, 2002, included the following:

Perkins loans receivable	$3,699,809.23
Less allowance for doubtful accounts	922,432.97
Total	$2,777,376.26

NOTE 6. CAPITAL ASSETS

Capital asset activity for the university for the year ended June 30, 2002, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$3,787,039.61	$662,184.90	$ -	$ -	$4,449,224.51
Land improvements and infrastructure	24,685,136.68	-	1,615,906.08	980,442.24	25,320,600.52
Buildings	191,505,679.92	3,162,450.00	2,613,816.38	906,728.38	196,375,217.92
Equipment	28,844,033.34	2,258,977.00	-	2,142,896.87	28,960,113.47
Library holdings	13,995,011.59	2,065,839.33	-	1,370,134.59	14,690,716.33
Projects in progress	2,756,272.60	3,364,844.56	(4,229,722.46)	-	1,891,394.70
Total	265,573,173.74	11,514,295.79	-	5,400,202.08	271,687,267.45
Less accum. depreciation:					
Land improvements and infrastructure	9,942,385.80	1,236,134.19	-	-	11,178,519.99
Buildings	63,531,264.09	4,826,912.54	-	169,188.47	68,188,988.16
Equipment	17,366,706.42	2,425,508.67	-	13,633.57	19,778,581.52
Library holdings	6,603,565.40	1,606,085.10	-	1,370,134.59	6,839,515.91
Total accum. depreciation	97,443,921.71	10,094,640.50	-	1,552,956.63	105,985,605.58
Capital assets, net	$168,129,252.03	$1,419,655.29	$ -	$3,847,245.45	$165,701,661.87

Capital asset activity for the foundation for the year ended June 30, 2002, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$3,669,146.20	$ -	$ -	$53,800.00	$3,615,346.20
Equipment	194,020.00	15,900.00	-	5,900.00	204,020.00
Livestock	238,672.00	-	-	238,672.00	-
Construction in progress	1,561,012.55	11,696,093.06	-	-	13,257,105.61
Total	5,662,850.75	11,711,993.06	-	298,372.00	17,076,471.81
Less accum. depreciation:					
Equipment	159,533.33	7,026.03	-	-	166,559.36
Capital assets, net	$5,503,317.42	$11,704,967.03	$ -	$298,372.00	$16,909,912.45

NOTE 7. LONG-TERM LIABILITIES

Long-term liabilities activity for the year ended June 30, 2002, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
Bonds	$69,547,416.50	$8,375,141.28	$1,925,603.96	$75,996,953.82	$2,390,069.35
Commercial paper	5,034,110.81	117,365.18	3,284,342.04	1,867,133.95	-
Subtotal	74,581,527.31	8,492,506.46	5,209,946.00	77,864,087.77	2,390,069.35
Other liabilities:					
Compensated absences	3,449,731.43	2,215,500.38	1,877,394.82	3,787,836.99	1,668,834.24
Due to grantors	-	3,457,034.74	175,000.00	3,282,034.74	-
Subtotal	3,449,731.43	5,672,535.12	2,052,394.82	7,069,871.73	1,668,834.24
Total long-term liabilities	$78,031,258.74	$14,165,011.58	$7,262,340.82	$84,933,959.50	$4,058,903.59

Bonds Payable

Bond issues, with interest rates ranging from 3.65% to 7.75% for Tennessee State School Bond Authority bonds are due serially to 2030 and are secured by pledges of the facilities' revenues to which they relate and certain other revenues and fees of the university, including state appropriations. The bonded indebtedness with the Tennessee State School Bond Authority reported on the statement of net assets is shown net of assets held by the authority in the debt service reserve. The reserve amount was $907,739.11 at June 30, 2002.

Debt service requirements to maturity for bonds payable at June 30, 2002, are as follows:

Year Ending June 30	Principal	Interest	Total
2003	$ 2,390,069.35	$4,147,169.60	$ 6,537,238.95
2004	2,522,927.44	4,016,615.75	6,539,543.19
2005	2,418,430.01	3,896,899.10	6,315,329.11
2006	2,446,690.06	3,780,741.54	6,227,431.60
2007	2,570,342.09	3,662,031.22	6,232,373.31
2008-2012	14,273,675.17	16,355,451.29	30,629,126.46
2013-2017	16,092,655.88	12,519,409.18	28,612,065.06
2018-2022	14,082,694.75	8,167,176.61	22,249,871.36
2023-2027	14,689,043.89	3,857,432.43	18,546,476.32
2028-2030	4,510,425.18	385,108.61	4,895,533.79
	$75,996,953.82	$60,788,035.33	$136,784,989.15

Commercial paper

The Tennessee State School Bond Authority also authorized the issuance of commercial paper to finance the costs of various capital projects. The amount issued for projects at the university was $1,867,133.95 at June 30, 2002.

For the commercial paper program, the Tennessee State School Bond Authority maintains an interest rate reserve fund. The university contributes amounts to the reserve fund based on the amounts drawn. The principal of the reserve will be contributed to pay off notes or credited back to the university when the notes are converted to bonds. The interest earned on the reserve is used to pay interest due during the month.

NOTE 8. UNRESTRICTED NET ASSETS

Unrestricted net assets include funds that have been designated or reserved for specific purposes. These purposes include the following:

	Amount
Working capital	$ 2,147,991.99
Encumbrances	1,649,730.86
Designated fees	438,769.97
Auxiliaries	4,004,895.82
Quasi-endowment	155,100.00
Plant construction	6,346,886.34
Renewal and replacement of equipment	12,477,731.47
Debt retirement	837,408.27
Total	$28,058,514.72

NOTE 9. PENSION PLANS

A. Defined Benefit Plan

Tennessee Consolidated Retirement System

Plan Description - The university contributes to the State Employees, Teachers, and Higher Education Employees Pension Plan (SETHEEPP), a cost-sharing, multiple-employer, defined benefit pension plan administered by the Tennessee Consolidated Retirement System (TCRS). TCRS provides retirement, death, and disability benefits as well as annual cost-of-living adjustments to plan members and their beneficiaries. Title 8, Chapters 34-37, *Tennessee Code Annotated*, establishes benefit provisions. State statutes are amended by the Tennessee General Assembly.

The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for SETHEEPP. That report may be obtained by writing to the Tennessee Department of the Treasury, Consolidated Retirement System, 10th Floor Andrew Jackson Building, Nashville, Tennessee 37243-0230, or by calling (615) 741-8202.

Funding Policy - Plan members are noncontributory. The university is required to contribute an actuarially determined rate. The current rate is 6.19% of annual covered payroll. Contribution requirements for the university are established and may be amended by the TCRS' Board of Trustees. The university's contributions to TCRS for the years ended June 30, 2002, 2001, and 2000, were $2,165,347.75, $2,107,764.38, and $1,845,660.41. Contributions met the requirements for each year.

B. Defined Contribution Plans

Optional Retirement Plans (ORP)

Plan Description - The university contributes to three defined contribution plans: Teachers Insurance and Annuity Association–College Retirement Equities Fund (TIAA-CREF), Aetna Life Insurance and Annuity Company, and Variable Annuity Life Insurance Company (VALIC). These plans are administered by the Tennessee Department of the Treasury. Each plan provides retirement benefits to faculty and staff who are exempt from the overtime provisions of the Fair Labor Standards Act and who waive membership in the TCRS. Benefits depend solely on amounts contributed to the plan plus investment earnings. Plan provisions are established by state statute in Title 8, Chapter 35, Part 4, *Tennessee Code Annotated.* State statutes are amended by the Tennessee General Assembly.

Funding Policy - Plan members are noncontributory. The university contributes an amount equal to 10% of the employee's base salary up to the social security wage base and 11% above the social security wage base. Contribution requirements are established and amended by state statute. The contribution made by the university to the plans was $4,977,476.97 for the year ended June 30, 2002, and $4,551,987.92 for the year ended June 30, 2001. Contributions met the requirements for each year.

NOTE 10. OTHER POST-EMPLOYMENT BENEFITS

The State of Tennessee administers a group health insurance program which provides post-employment health insurance benefits to eligible university retirees. This benefit is provided and administered by the State of Tennessee. The university assumes no liability for retiree health care programs. Information related to this plan is available at the statewide level in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

NOTE 11. CUMULATIVE EFFECTS OF CHANGES IN ACCOUNTING PRINCIPLE

During the year ended June 30, 2002, the university implemented GASB Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and GASB Statement 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*. As a result of this implementation, the university was required to make changes in certain accounting principles, specifically the (1) adoption of capitalization criteria of $100,000 and $50,000 for buildings and additions, respectively; (2) adoption of depreciation on capital assets; (3) recording of certain summer semester revenues between fiscal years rather than in the fiscal year in which the semester was predominantly conducted; (4) reclassification of the U.S. government grants refundable amount as a liability; and (5) adoption of capitalization criteria of $5,000 for livestock. The cumulative effects of these changes on net assets are shown below:

Adoption of capitalization criteria for buildings and additions	$ (2,234,914.27)
Adoption of depreciation on capital assets	$(127,466,383.88)
Deferred revenue recognition	$ 799,665.81
Reclassification of U.S. government grants refundable	$ (2,503,034.37)
Adoption of capitalization criteria for livestock	$ (270,110.00)

NOTE 12. INSURANCE-RELATED ACTIVITIES

The state purchases commercial insurance for real property losses above $5 million per year and surety bond coverage on the state's officials and employees. In the past three fiscal years, the state has not had any claims filed with the commercial insurer. Designations for casualty losses in the amount of $5 million for deductibles and $1.356 million for incurred losses at June 30, 2002, were established in the state's general fund to provide for any property losses not covered by the commercial insurance.

At June 30, 2002, the scheduled coverage for the university was $345,598,800 for buildings and $153,539,100 for contents.

The state has set aside assets for claim settlement in an internal service fund, the Claims Award Fund. This fund services all claims for risk of loss to which the state is exposed, including general liability, automobile liability, professional malpractice, and workers' compensation. The university participates in the Claims Award Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on a percentage of the university's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of fiscal year-end to determine the fund liability and premium allocation. Since the university participates in the Claims Award Fund, it is subject to the liability limitations under the provisions of the Tennessee Claims Commission Act, *Tennessee Code Annotated*, Section 9-8-101 et seq. Liability for negligence of the university for bodily injury and property damage is limited to $300,000 per person and $1,000,000 per occurrence. The limits of liability under workers' compensation are set forth in *Tennessee Code Annotated,* Section 50-6-101 et seq. Claims are paid through the state's Claims Award Fund.

The state has also set aside assets in the Employee Group Insurance Fund, an internal service fund, to provide a program of health insurance coverage for the employees of the state with the risk retained by the state. The university participates in the Employee Group Insurance Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on estimates of the ultimate cost of claims that have been reported but not settled and of claims that have been incurred but not reported. Employees and providers have 13 months to file medical claims.

NOTE 13. COMMITMENTS AND CONTINGENCIES

Sick Leave - The university records the cost of sick leave when paid. Generally, since sick leave (earned one day per month with unlimited accumulation) is paid only when an employee dies or is absent because of illness, injury, or related family death, there is no liability for sick leave at June 30. The dollar amount of unused sick leave was $34,315,469.73 at June 30, 2002.

Operating Leases - The university has entered into various operating leases for buildings and equipment. Such leases will probably continue to be required. Expenses under operating leases for real property were $178,581.94 and for personal property were $78,591.98 for the year ended June 30, 2002. All operating leases are cancelable at the lessee's option.

Construction in Progress - At June 30, 2002, outstanding commitments under construction contracts totaled $4,670,337.77 for the Development Facility, Todd renovation, housing study renovations, several building roof replacements, Keathley University Center, Honors College, and life safety renovations, which will be funded by future state capital outlay appropriations.

Litigation - The university is involved in several lawsuits, none of which are expected to have a material effect on the accompanying financial statements.

NOTE 14. CHAIRS OF EXCELLENCE

The university had $20,277,808.31 on deposit at June 30, 2002, with the State Treasurer for the university's Chairs of Excellence program. These funds are held in trust by the state and are not included in the financial statements.

NOTE 15. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The university's operating expenses by functional classification for the year ended June 30, 2002, are as follows:

	Natural Classification					
Functional Classification	Salaries	Benefits	Operating	Scholarships	Depreciation	Total
Instruction	$56,447,943.96	$12,889,064.42	$10,325,841.47	$2,283,815.40	$ -	$81,946,665.25
Research	1,708,018.97	321,200.78	620,192.06	45,859.40	-	2,695,271.21
Public service	2,733,048.65	688,237.86	2,471,583.39	257,161.53	-	6,150,031.43
Academic support	8,637,282.59	2,269,994.48	240,842.90	87,553.41	-	11,235,673.38
Student services	8,477,153.35	2,239,676.82	7,887,583.36	3,244,343.43	-	21,848,756.96
Institutional support	7,769,151.83	2,100,682.88	2,903,496.14	83,279.91	-	12,856,610.76
Operation & maint.	4,801,871.60	1,514,211.64	13,636,385.11	10,000.00	-	19,962,468.35

Scholar. & fellow.	-	-	7,714.72	4,838,595.95	-	4,846,310.67
Auxiliary	4,782,018.58	1,168,097.21	11,976,212.72	20,582.26	-	17,946,910.77
Depreciation	-	-	-	-	10,094,640.50	10,094,640.50
Total	$95,356,489.53	$23,191,166.09	$50,069,851.87	$10,871,191.29	$10,094,640.50	$189,583,339.28

NOTE 16. PRIOR-YEAR RESTATEMENT

The invested in capital assets, net of related debt at June 30, 2001, was restated to reflect the following prior period adjustments: (1) capitalization of stadium turf replacement not previously recorded in the amount of $492,014.86, (2) removal of glass repair totaling $84,270.00 previously capitalized, (3) removal of old telephone system in the amount of $2,109,944.10 not removed when new system was installed, and (4) removal of electronic media databases previously capitalized as library holdings for $227,314.69. The net effect was a decrease in net assets of $1,929,513.93.